

STATE OF LOUISIANA LEGISLATIVE AUDITOR

Office of Risk Management
Executive Department
State of Louisiana
Baton Rouge, Louisiana

March 7, 2001



Financial and Compliance Audit Division

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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**OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA**
Baton Rouge, Louisiana

Management Letter
Dated December 7, 2000

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

March 7, 2001



DANIEL G. KYLE, PH.D., CPA, CFE
LEGISLATIVE AUDITOR

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December 7, 2000

**OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA**
Baton Rouge, Louisiana

As a part of our audit of the State of Louisiana's financial statements for the year ended June 30, 2000, we considered the Office of Risk Management's internal control over financial reporting; we examined evidence supporting certain accounts and balances material to the State of Louisiana's financial statements; and we tested the office's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements as required by *Government Auditing Standards*.

The Annual Fiscal Report of the Office of Risk Management is not audited or reviewed by us, and, accordingly, we do not express an opinion on that report. The office's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses an opinion.

In our prior management letter on the Office of Risk Management for the year ended June 30, 1999, we reported findings concerning the lack of an effective internal audit function and the overstatement of reserves for claim payments. These findings are addressed again in this letter.

Based on the application of the procedures referred to previously, all significant findings are included in this report for management's consideration.

Lack of Internal Audit Function

For the seventh consecutive year, the Office of Risk Management (ORM) did not have an effective internal audit function to examine, evaluate, and report on its internal control and to evaluate its compliance with the policies and procedures of the control system. Act 10 of the 1999 Regular Session of the Louisiana Legislature requires agencies with budgets in excess of \$30 million to use existing program resources and the table of organization to establish an internal auditor position. Considering the size of ORM's reported assets (\$180,953,169) and revenues (\$137,622,742), an effective internal audit function is needed to ensure that assets are safeguarded and that management's policies and procedures are uniformly applied.

Although ORM had an internal auditor for 10 months during the previous fiscal year, in May 1999, he was detailed into another position. Management did not fill this position in fiscal year ended June 30, 2000.

**OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA**

Management Letter, Dated December 7, 2000

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ORM should reestablish the internal audit function to provide assurance that assets are safeguarded and to ensure that management's policies and procedures are applied in accordance with management's intentions. Management concurred with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 1-2).

**Workers' Compensation Claims and Reserves
Not Properly Controlled**

The Workers' Compensation unit of ORM did not have adequate internal control over claims, in particular those relating to the Second Injury Fund. Louisiana Revised Statute (R.S.) 39:1527, et al., created ORM as the state's self-insurance agency. As such, ORM is responsible for handling claims filed against the state, including workers' compensation claims. The Second Injury Fund exists to encourage the employment of physically handicapped employees who have a permanent, partial disability by protecting employers and their insurers from excess liability when a subsequent injury to such an employee merges with his preexisting disability. R.S. 23:1378 divides the financial responsibility for paying Second Injury claims between the insurer (which is ORM in this case) and the Second Injury Fund. In addition, the statute sets limits for insurer reserves for future payments and states that no reimbursement will be made to the insurer unless the insurer complies with those limits on reserves.

A general operational review of the Workers' Compensation unit disclosed the following conditions:

1. Medical invoices were not processed through ORM's fee scheduler according to ORM procedures, but were paid according to the amount per the invoices. Fee scheduling includes independent checks for duplicate claims and limits payments for medical services to national norms, which are sometimes less than the invoice amount. The claims were not properly processed because the unit had three vacant adjuster positions during fiscal year ended June 30, 2000.
2. Adequate training, supervision, and review was not provided to the adjusters for certain aspects of processing workers' compensation claims, in particular supplemental employee benefits. As a result, the reserves for claims may have been overstated, causing a misstatement of liabilities in the state's financial statements.

In addition, the following conditions relating to Second Injury claims were noted:

1. Reimbursements received from the Second Injury Fund were not compared to the reimbursement request to ensure that the appropriate

**OFFICE OF RISK MANAGEMENT
EXECUTIVE DEPARTMENT
STATE OF LOUISIANA**

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reimbursement was received. Consequently, errors would not be detected in a timely manner.

2. In a test of five Second Injury claims totaling \$351,448, ORM failed to request reimbursement from the Second Injury Board for medical expenses for two claims for \$1,495 before the closing of the claim. In addition, ORM failed to timely request reimbursement for compensation from the Second Injury Board for one claim for \$11,077 and was eventually forced to waive its right to the reimbursement. Failure to request reimbursement in a timely manner affects the agency's ability to recover costs.
3. In a test of 20 claims totaling \$722,468 relating to the Second Injury Fund reserves, the reserves for compensation for three claims were overstated by \$58,128, causing a violation of R.S. 23:1378.

Management indicated that a shortage of personnel was the primary reason for the concerns cited above and agreed that additional employee training may be needed. During the audit, management conducted a training session with adjusters in an effort to prevent further errors or misunderstandings from affecting the department's operations and financial statements.

ORM should (1) ensure that all medical invoices relating to workers' compensation are processed through the fee schedulers; (2) ensure that adjusters receive adequate supervision and review in performing their responsibilities; (3) compare the amount of Second Injury reimbursements to the amount requested to ensure that the appropriate reimbursement is received; (4) request timely reimbursements from the Second Injury Fund; and (5) comply with legal limits on reserves for Second Injury claim payments. Management concurred with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 3-5).

Ongoing Investigation of Fraud

On December 7, 2000, Seth E. Keener, Jr., ORM State Risk Director, notified the Legislative Auditor of an embezzlement of funds. In a letter dated December 8, 2000, Mr. Keener explained the situation as follows:

"On December 4, 2000, this office was made aware of a security problem involving embezzlement of funds. From an outside source, one of ORM's claims managers was informed late Thursday, November 30, 2000, that we may have a problem. I became aware early Monday, December 4, 2000.

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EXECUTIVE DEPARTMENT
STATE OF LOUISIANA**

Management Letter, Dated December 7, 2000

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"An employee in our Claims Unit, Carry Emerson, a Claims Examiner 2, has been accused of establishing fraudulent claims, making payments to individuals falsely and then sharing the proceeds of the check. Another employee in Claims, Annette Carroll, a Clerk 4, has confessed involvement. A third employee in our Accounting Unit, Cassandra Zanders, has been implicated although she denies involvement. These three employees have been put on suspension pending further investigation.

"On Monday, the probability of theft was reported to the Commissioner [of Administration] and to the City Police, who began an immediate investigation.

"At this point we have not determined a figure although it is believed to be a substantial sum. Evidently the embezzlement has taken place over a period of two years."

Investigators from the Office of the Legislative Auditor, the Baton Rouge City Police Department, and the East Baton Rouge Parish District Attorney's office are currently conducting an investigation of this embezzlement.

The recommendations in this letter represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the office. The varying nature of the recommendations, their implementation costs, and their potential impact on the operations of the office should be considered in reaching decisions on courses of action. The finding relating to the office's compliance with laws and regulations should be addressed immediately by management.

This letter is intended for the information and use of the office and its management and is not intended to be and should not be used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel G. Kyle".

Daniel G. Kyle, CPA, CFE
Legislative Auditor

ALE:DLH:DSP:ss

{ORM00}

Appendix A

Management's Corrective Action Plans and Responses to the Findings and Recommendations



M. J. "MIKE" FOSTER, JR.
GOVERNOR

State of Louisiana
DIVISION OF ADMINISTRATION
OFFICE OF RISK MANAGEMENT

MARK C. DRENNEN
COMMISSIONER OF ADMINISTRATION

August 15, 2000

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
Office of the Legislative Auditor
State of Louisiana
P O Box 94397
Baton Rouge, LA 70804

RE: Response to Legislative Audit Finding

Dear Dr. Kyle:

I concur with the finding Lack of Internal Audit Function. The Office of Risk Management has attempted to establish an internal audit function in the past and has not succeeded (See Audit 98/99).

For several years in sequence, ORM's TO has been cut by the Office of State Planning and Budget. At one time, ORM had a TO of 141. For the year 2000/2001, our TO was initially reduced to 123 and then was returned to 130 by the 2000 Legislature.

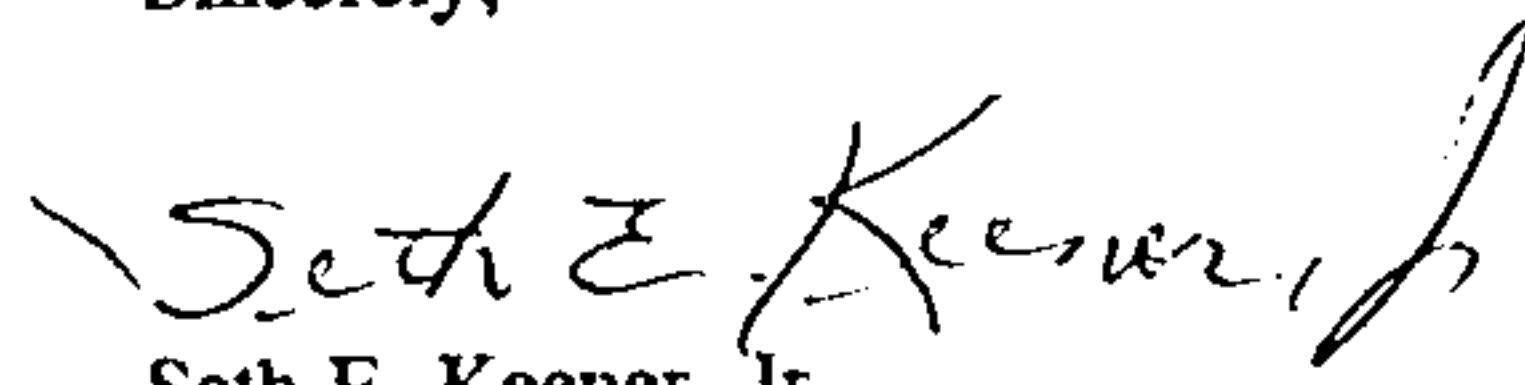
ORM had planned to fill the position in May 2000. The Executive Order instituting the freeze was effective May 5, 2000.

The Office of Risk Management is well aware of how important this position is. However, when we must choose between filling adjuster positions and loss prevention positions, and filling the internal auditor position, our choice must be directed to handling our workload in Claims and Loss Prevention.

Dr. Daniel G. Kyle
August 15, 2000
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The freeze is currently effective through September 30, 2000. We currently have 122 filled positions. We have received an exemption to hire eight (8) positions. At this time, the Internal Auditor position will not be one of the eight (8) positions, as these will be seven (7) claim handling positions, and one (1) loss prevention officer. We need these positions at a minimum to survive.

Sincerely,

A handwritten signature in cursive script, reading "Seth E. Keener, Jr.", with a large, stylized flourish at the end.

Seth E. Keener, Jr.
State Risk Director

SEK/ELW/tb



State of Louisiana
DIVISION OF ADMINISTRATION
OFFICE OF RISK MANAGEMENT

M. J. "MIKE" FOSTER, JR.
GOVERNOR

MARK C. DRENNEN
COMMISSIONER OF ADMINISTRATION

November 22, 2000

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
P.O. Box 94397
Baton Rouge, La. 70804-9397

Dear Dr. Kyle:

We concur with your finding on Worker's Compensation Claims and Reserves not Properly Controlled. Although we do concur with the finding, we wish to make the following comments:

The Workers Compensation section of ORM has been severely impacted by the freeze and the action of the Division of Administration State Budget Office. Several years ago our TO was at 141. Each year it has been cut two or more positions. The most recent legislative session was presented with the most recent recommended cut which was an additional 14 positions. Before the session concluded Senator Hainkle was successful in adding back 7 positions, making the total 130.

Subsequently, we were told that the Commissioner of Administration cut the 7 positions added by the Legislature.

We have been trying since July 1, 2000 to get this issue resolved so that we can hire additional adjusters. The Workers' Compensation section is currently suffering from the following vacancies:

St. Risk Claims Adjuster III
St. Risk Claims Adjuster II
Clerk IV
Clerk Chief I

In addition to the above positions the Claims unit has the following vacancies:

Clerk IV
St. Risk Claims Adjuster II
St. Risk Claims Adjuster II
St. Risk Claims Adjuster II
Insurance Claims Examiner III
Clerk IV
Office Manager 2
Clerk III
Clerk Chief I
Clerk IV
Clerk IV

The following positions are not located in Claims but are also vacant ORM positions:

Office Coordinator I
Clerk Chief I
St. Risk Underwriter II
Auditor II

We currently have higher level positions doing clerical work in addition to their regular duties because the agency is lacking sufficient clerical positions.

It is my opinion that if the number of positions in classified service should be cut, then a concerted effort should be made to determine what positions could be eliminated for the economic betterment of the State.

Corrective Action Planned

Ms. Karen Jackson, Claims Manager, is directly responsible for the Workers Compensation unit.

Recently (effective November 20) we have initiated a restructure in Claims as follows:

The Subrogation Unit in Workers Compensation has been desolved and the cases being handled by this unit are being returned to the original adjuster for action on subrogation.

The Supervisor of the Unit, Mr. Al Jenkins, will supervise an additional regular workers compensation unit with 1 adjuster 3, 1 adjuster 1, and 3 claims examiners handling medical

Letter to Dr. Kyle
November 22, 2000
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only claims. The addition of an experienced adjuster 3 to this unit will help strengthen the unit and will utilize an experienced employee to assist with training the less experienced adjusters.

This change has already been implemented and will result in an improvement in the claims unit.

Should you have any further questions please advise.

Sincerely,

A handwritten signature in cursive script, reading "Seth E. Keener, Jr.", followed by a large, stylized flourish.

Seth E. Keener, Jr.
State Risk Director

SEK/ELW/kg